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Eastern Europe
The Growing Hard-Currency Debt

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Central Intelligence Agency
Directorate of Intelligence

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Summary

East European hard-currency debt quintupled in 1971-76, hitting US $26 billion by yearend 1976. In 1974-75 soaring world commodity prices, economic recession in the West, and extraordinary grain imports added greatly to the heavy borrowing already planned by the East European countries to help fuel economic development. Attempts to reduce trade deficits and to slow the growth of indebtedness in 1976 met with mixed results. The trade deficit for the area as a whole dropped to $6.3 billion from the record $6.7 billion incurred in 1975 as exports picked up and import growth slowed. But Czechoslovakia, East Germany, and Poland–requiring large imports of grain–failed to reduce their deficits.

The East Europeans continued to draw on large amounts of Western government-backed credits, but unexpectedly large trade deficits in 1974-76 necessitated heavy borrowings in the Euromarket, boosting the net Euromarket liabilities and increasing the burden of short-term debt. Poland–eager for advanced Western technology and equipment–permitted the fastest growth in its debt, particularly in short-term Euromarket borrowing. At yearend 1976, its hard-currency debt stood at about $10 billion. By 1976, Western bankers–concerned over the sharply rising level of debt and, in some cases, approaching their lending limits–were becoming concerned over the rapid growth and size of the East European debt. Nevertheless, they continued to provide most of the funds sought by the East Europeans.

With heavy debt burdens and continued uncertainties in their Western markets, the East Europeans are faced with difficult choices. In order to keep new borrowing down, they will have to restrict the growth of imports

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from the West while attempting to maximize exports. Since economic growth depends to an important degree on imports of Western capital goods and industrial materials, cutbacks in import growth will impact negatively on the economic health of the East European countries. Maintaining a modicum of growth in consumer welfare will be necessary in order to minimize consumer discontent, especially in Poland.

Eastern Europe
The Growing Hard-Currency Debt

The Debt Builds, 1971-75...

The net hard-currency debt of the East European countries soared from $5 billion to $19 billion during 1971-75. Although these countries had programed large increases in capital goods imports to be financed partly with Western credits, indebtedness was not expected to reach such proportions. In addition to sharply boosting imports of Western technology and equipment, the East Europeans required increasingly large imports of industrial materials from the West to compensate for a slowdown in the growth of imports from the USSR.

East European exports to the developed West failed to keep pace with imports throughout the period, growing 20 percent a year compared with 29 percent a year for imports (see table 1).[1] The East European trade deficit doubled in 1973—mainly as a result of the quadrupling of the Polish deficit—and doubled again in 1974 as import prices for oil, chemicals, steel, cotton, grain, and soybean meal soared. In 1975, the Western recession caused East European exports to slump, boosting the deficit to a record $6.7 billion in spite of efforts to cut back on import growth. Poland alone racked up a $3 billion deficit. Romania, by cutting imports sharply, was the only country able to keep its deficit from rising in 1975.

As a result of these deficits, Eastern Europe had accumulated a $19 billion debt by the end of 1975. Poland's debt totaled $6.9 billion; East Germany and Romania had debts of $3.8 billion and $3 billion, respectively (see table 2). Poland—eager for advanced Western technology and equipment—permitted the fastest growth of its debt. Other countries such as Czechoslovakia, Hungary, and Romania exercised considerably more prudence in borrowing.

The rapid rise in East European imports of Western machinery and equipment was made possible for the most part by Western extensions of large amounts of government-backed credits. By yearend 1975, the amount outstanding on government-backed credits represented roughly one-fourth of total East European indebtedness.

At the same time, private borrowing from commercial banks played an increasingly impor-

[1] Only trade with the developed West is discussed in this paper. Hard-currency trade with the less developed countries is difficult to calculate because of inadequate information (see appendix B). The amount involved, however, is considered to be small for most of the East European countries.

Note:This memorandum discusses hard-currency indebtedness and the factors that led to the buildup of this debt in the East European countries (Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania). The discussion also deals with the hard-currency invisibles balances of Hungary, Poland, and Romania. Insufficient data preclude a discussion of the invisibles balances of the other three countries. [redacted] 25X1

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Eastern Europe: Trade With the Developed West [1] **Table 1**

Million US $

	1970	1971	1972	1973	1974	1975 [2]	1976 [3]
Exports	**4,134**	**4,556**	**5,599**	**7,935**	**10,676**	**10,358**	**11,600**
Imports	**4,834**	**5,399**	**7,000**	**10,745**	**16,030**	**17,030**	**17,940**
Balance	**−700**	**−843**	**−1,401**	**−2,810**	**−5,354**	**−6,672**	**−6,340**
Bulgaria							
Exports	260	285	310	403	403	397	450
Imports	324	338	349	480	928	1,139	1,000
Balance	−64	−53	−39	−77	−525	−742	−550
Czechoslovakia							
Exports	746	820	921	1,266	1,639	1,600	1,730
Imports	880	966	1,056	1,513	2,031	2,178	2,370
Balance	−134	−146	−135	−247	−392	−578	−640
East Germany							
Exports	1,058	1,134	1,406	1,915	2,646	2,586	2,850
Imports	1,350	1,415	1,929	2,735	3,540	3,630	3,900
Balance	−292	−281	−523	−820	−894	−1,044	−1,050
Hungary							
Exports	558	549	739	1,085	1,221	1,096	1,290
Imports	623	790	851	1,135	1,862	1,843	1,860
Balance	−65	−241	−112	−50	−641	−747	−570
Poland							
Exports	962	1,099	1,397	2,063	2,865	3,026	3,330
Imports	901	1,075	1,772	3,431	5,233	6,076	6,660
Balance	61	24	−375	−1,368	−2,368	−3,050	−3,330
Romania							
Exports	550	669	826	1,203	1,902	1,653	1,950
Imports	756	815	1,043	1,451	2,436	2,164	2,150
Balance	−206	−146	−217	−248	−534	−511	−200

[1] Australia, Austria, Belgium, Canada, Denmark, Finland, France, Iceland, Ireland, Italy, Japan, Liechtenstein, Luxembourg, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the United Kingdom, the United States, and West Germany.

[2] The data for Bulgaria and East Germany are estimated.

[3] The data for Bulgaria, East Germany, and Romania are estimated. The data for the other countries are partially estimated.

SOURCE: Official East European foreign trade statistics. All exports and imports are f.o.b. except for Hungary which reports imports on a c.i.f. basis.

tant role as rapidly growing deficits and debt servicing obligations necessitated the greater use of financial credits. A large part of the commercial bank borrowing was on a direct bank-to-bank basis whereby the East Europeans obtained time deposits and other credits.[2] The

[2] Some of the East European borrowing from commercial banks was indirect, resulting from the discounting—mostly on a nonrecourse basis—of private supplier credits by Western firms with their banks. Such supplier credits are believed to run up to five years in length. Nonrecourse, or *a forfait*, financing is a form of supplier's financing whereby the bank accepting bills or notes from an exporter for discount absorbs the risks of collecting payment from the importer.

Eastern Europe: Estimated Net Hard-Currency Debt [1] At Yearend **Table 2**

Billion US $

	1970	1973	1974	1975	1976 [2]
Total Debt	**4.6**	**8.5**	**13.1**	**19.1**	**25.6**
Bulgaria	0.7	0.8	1.2	1.8	2.3
Czechoslovakia	0.3	0.8	1.1	1.5	2.1
East Germany	1.0	2.1	2.8	3.8	4.9
Hungary	0.6	0.9	1.5	2.1	2.8
Poland	0.8	1.9	3.9	6.9	10.2
Romania	1.2	2.0	2.6	3.0	3.3

[1] The methodology for estimating East European hard-currency debt is in Appendix A.

[2] Preliminary estimates.

advantage of such credits is that they can—unlike government-backed and other supplier credits that are tied to specific purchases—be used to cover immediate needs. On the other hand, these credits generally carry higher interest rates and are of shorter duration than government-backed credits.

Total net liabilities to commercial banks are estimated to have accounted for somewhat more than one-half of total East European indebtedness by yearend 1975, up from roughly two-fifths at yearend 1973. In 1975, reported liabilities on the Euromarket rose by $4 billion while East European assets rose by $700 million; reported net liabilities stood at $8.7 billion at yearend 1975 (see appendix C, table C-1).[3] About one-third of the increase in commercial bank borrowing in 1975 consisted of publicized medium- and long-term syndicated loans with repayment periods running up to seven years.

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Other sources of financing included direct Middle East placements—largely to Romania—totaling at least $700 million by yearend 1975. The East Germans benefited from an interest-free West German swing credit, which had accumulated to about $300 million. The East Europeans also borrowed from Council for Mutual Economic Assistance (CEMA) banks and on nongovernment-backed supplier credits which do not appear in Bank for International Settlements (BIS) statistics. However, data on these sources of financing, as well as on direct Middle East placements, are incomplete. Thus, the estimates of East European debt are probably conservative.

...and Builds, 1976

Burgeoning trade deficits and mounting debts forced the East European countries to take steps in 1976 to reduce these deficits. The results were mixed. For the area as a whole, the trade deficit is estimated to have dropped by $330 million to $6.3 billion as exports picked up and import growth slowed down. Bulgaria and Romania—already carrying heavy debt burdens—and Hungary—usually a cautious borrower—took stringent measures to reduce their trade deficits. All three were able to cut their deficits sharply, with Romania being the most successful. On the other hand, Czechoslovakia, East Germany, and Poland were unable to reduce their deficits largely because of large imports of grain and fodder necessitated by poor harvests and the suspension of Soviet grain deliveries. By yearend, East European debt had climbed to $26 billion.

Nevertheless, most East European countries apparently had little trouble in financing their 1976 deficits and meeting mounting repayment obligations. Substantial government-backed credits continued to be available. Reported net Euromarket liabilities of Eastern Europe rose by $3.8 billion compared with $3.3 billion in 1975 and totaled $12.5 billion by the end of the year. About one-third of the rise in Euromarket liabilities consisted of medium- and long-term syndicated loans. Money markets were very liquid as an expected strong competition for funds failed to materialize because of the sluggish Western economic recovery. In general, the East Europeans were able to borrow at the same spreads above the London Interbank Offered Rate (LIBOR) as in 1975, although management and other fees may have been higher.

In spite of the availability of funds, Western bankers began to indicate concern over Eastern Europe's rapidly growing debt. Many lenders became unwilling to extend additional large untied loans—especially to Poland. Some of the project loans were tied only loosely to East European purchases in the West, for example, a $120 million syndicated loan to Bulgaria for the development of the chemical industry. Others were extended for a specific project, for example, a $100 million syndicated loan to Poland to

[3] According to US Treasury and Federal Reserve statistics, US-based banks and their major foreign branches held $1,188 million in net claims against Eastern Europe at the end 1975. About three-fourths of these claims were held by the foreign branches.

help pay for equipment for a polyvinyl chloride plant from the United Kingdom, Japan, and the United States. But if, as is likely, such loans are drawn down before delivery of the equipment, they can then be used for immediate balance-of-payments purposes.

Moreover, some banks may be near legal or self-imposed ceilings for individual borrowers on East European financing. The East Europeans, however, may be able to sidestep this problem by having some institution other than the foreign trade banks apply for the financing. In 1976, the Polish shipping enterprise Polska Zegluga Morska took up a $20 million, five-year loan managed by First Chicago Ltd.

Only Poland is believed to have encountered serious difficulties in meeting its 1976 needs for balance-of-payments financing.

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Poland—The Financial Vise Tightens

Poland, with rapidly rising debt and debt service obligations, faces the most difficulty among the East European countries in bringing its external accounts into equilibrium. Gierek—in a reversal of his predecessor Gomulka's more cautious approach—has used Western credits to import large amounts of capital equipment to push rapid economic development and modernize the Polish economy and to raise the standard of living of urban workers. At the same time, Poland had to sharply increase its imports of Western industrial materials, especially metallurgical products, and, in 1975 and 1976, to import extraordinary amounts of Western grain and fodder.

As a result of the rapid rise in imports, Poland's trade surpluses of the 1960s and early 1970s turned to deficits by 1972. The deficit quadrupled in 1973, in large part because of the deterioration in the terms of trade, which was mainly due to sharp increases in the prices of imported agricultural products. The trade deficit nearly doubled in 1974. Although the value of Poland's exports increased by 39 percent, the volume dropped slightly as a result of the EC ban on beef and cattle imports and the beginning of the Western recession late in the year. At the same time, imports rose 53 percent, largely because of sharp increases in the price of oil and other raw materials. Although, as shown in table 3, the terms of trade improved substantially, the effect of the more rapid increase in export prices was more than offset by the fact that imports were nearly twice the level of exports.

Poland: Terms of Trade With The Developed West **Table 3**

Percent Change

	1971	1972	1973	1974	1975
Export prices	6.4	1.2	16.7	45.3	8.6
Import prices	−5.8	−2.1	28.0	32.8	3.3
Terms of trade	13.0	3.4	−8.8	9.4	5.1

SOURCE: "Terms of Trade in Polish Foreign Trade" by Anna Stepniewska and Hanna Molewicz, *Handel Zagraniczny* # 7, Warsaw, July 1976. (Translated by Joint Publications Research Service.)

Although Poland's import growth slowed to 16 percent in 1975, mostly a result of a sharp drop in the rate of increase in import prices, the deficit still climbed to $3 billion. Imports of machinery and equipment continued to soar and those of grain and fodder hit a record 7 million metric tons due to shortfalls in domestic production and Moscow's suspension of deliveries. Imports of rolled steel, on the other hand, fell. Exports rose only 6 percent (down 3 percent in real terms) as sales of foodstuffs, metallurgical products, and chemicals dropped sharply.

Invisibles contributed little to help cover Poland's large trade deficits; by 1975, mushrooming interest payments more than offset net earnings from transportation, tourism, and remittances (see table 4). Not only did Poland's net indebtedness rise substantially by yearend—to $6.9 billion—but a much larger share of exports was required to service the debt. Debt service jumped from 27 percent of merchandise exports in 1974 to 43 percent in 1975 (see appendix C, tables C-3 and C-4).

Poland: Estimated Hard-Currency Balance of Payments **Table 4**

Million US $

	1970	1973	1974	1975	1976
Merchandise exports, f.o.b.[1]	962	2,063	2,865	3,026	3,330
Merchandise imports, f.o.b.[1]	901	3,431	5,233	6,076	6,660
Services and transfers, net[2]	110	290	300	325	550[3]
Interest, net	-40	-80	-240	-400	-640
Current account balance	131	-1,158	-2,308	-3,125	-3,420
Financed by					
Medium- and long-term credits, net	-6	550	1,100	1,750	2,000
Errors and omissions[4]	-125	608	1,208	1,375	1,420

[1] Trade with the developed West.
[2] Includes balances on transport, tourism, and private and government transfers.
[3] Reflects the beginning of special payments from West Germany.
[4] Includes short-term borrowing as well as some credits of up to five years. Also included are hard-currency trade balances with the less developed countries and changes in foreign exchange reserves.

Although still relying heavily on government and government-guaranteed credits[4]—which accounted for nearly two-fifths of the total debt at yearend 1975—Poland was forced to boost its borrowing on the money market to cover the deficits and meet repayment obligations. In 1975, net private borrowing from commercial banks accounted for more than one-half of the $3 billion rise in the debt. Of this, some $500 million was in publicized syndicated loans of five years or more. By yearend, estimated net liabilities to commercial banks reached $4 billion. In addition, Poland owed about $400 million on West German supplier credits. [redacted] 25X1

Poland presumably has borrowed more than has been accounted for above. As a result of its heavy use of financial credits, many of which are short term, Poland's debt structure has worsened. Long-term debt dropped from about 60 percent of the total in 1970 to roughly 30 percent in 1975 (see Appendix C, table C-5). According to one report, short-term debt accounted for one-fifth of the total debt by yearend 1975; thus about one-half was accounted for by medium-term credits.

In spite of some recovery in exports and efforts to curb import growth in 1976, Poland incurred an even larger deficit than it did in 1975, reflecting a commitment to large imports of Western grain and of machinery and equipment. To reduce consumer grumbling over shortages, Warsaw cut back exports of coal and meat while maintaining grain imports in order to boost livestock production. Import growth was held down to 6.5 percent in the first 11 months of the year but shot up in December, apparently in large part because of sharp increases in deliveries of machinery and equipment; the rise in imports for the whole year was 10 percent. Exports also rose by 10 percent in 1976. In real terms, imports from and exports to the developed West probably grew faster. [redacted] in trade with all 25X1 non-Communist countries, import prices declined by 3 percent and export prices by 5 percent.

By the end of the year, Polish debt probably reached $10.2 billion. Poland required about $4.5 billion in financing in 1976 to cover the deficit and repayment obligations on earlier

[4] Poland's outstanding indebtedness on US government and government-backed credits at yearend 1975 totaled $375 million, of which $92 million were Eximbank credits, $48 million CCC credits, and $236 million P.L. 480 credits extended during 1957-64.

debts. Up to $2 billion in government and government-backed credits and $200 million extended by Iran in 1975 were available for use, leaving roughly $2 billion to meet the balance of its financial needs.

Because of the rapid buildup of its debt, Poland found it difficult to arrange for Western financial credits. Many lenders had become willing to participate only in credits tied to Polish imports [redacted] But, as indicated earlier, Poland may be able to draw down the funds before actual delivery of the equipment. In the first half of 1976, Poland's borrowings on the Euromarket were down substantially, partly because lenders were holding back in anticipation of a greater demand for funds from developed Western countries. When this demand failed to materialize, Poland was able to borrow enough in the second half to bring its net borrowings to $1.4 billion for the year, although it had to pay a higher interest rate than most other East European countries—1.5 percent over LIBOR.

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Feeling a payments crunch, Poland took several steps [redacted] It is not known if Poland obtained rescheduling from the French; nor are sufficient data available to determine how Poland met its financing needs in 1976, but presumably most of the funds consisted of private borrowing from commercial banks not included in the BIS reporting on Poland.

Romania—Debt Strains Force Import Curbs

Romania has also run up a large hard-currency debt because of substantial imports of Western technology and equipment to modernize its economy. Once the biggest borrower in Eastern Europe, Romania managed to keep its debts manageable in the early 1970s by restricting new borrowing and spreading out its debt; long-term debt rose from 20 percent of the total in 1970 to 40 percent in 1975, a higher share than for any other East European country except Hungary.

The strategy began to go awry in 1974, when soaring import prices helped push the trade deficit up to more than $500 million. Although the Ceausescu regime cut imports sharply in 1975, Romania again incurred a $500 million deficit. Imports of Western machinery leveled off after several years of rapid growth. Exports dropped about 13 percent because of lower Western demand for Romanian products and domestic short-falls in agricultural production. Most of the decline resulted from a 43-percent drop in exports of foodstuffs. The deficit on invisibles continued to climb as interest payments and net expenditures on transportation increasingly offset earnings from tourism (see table 5). The hard-currency debt rose from $2 billion at yearend 1973 to $3 billion at yearend 1975. The share of exports required to service the debt rose to 42 percent.

Romania: Estimated Hard-Currency Balance of Payments — **Table 5**

Million US $

	1970	1973	1974	1975	1976[1]
Merchandise exports, f.o.b.[2]	550	1,203	1,902	1,653	1,950
Merchandise imports, f.o.b.[2]	756	1,451	2,436	2,164	2,150
Services and transfers, net[3]	−60	−50	−20	−30	−50
Interest, net	−50	−120	−170	−190	−230
Current account balance	−316	−418	−724	−731	−480
Financed by					
Medium- and long-term credits, net	200	200	650	450	300
Errors and omissions[4]	116	218	74	281	180

[1] Provisional.

[2] Trade with the developed West, including Finland with which Romania settles on a clearing basis.

[3] Includes balances on transport, tourism, and private and government transfers.

[4] Includes short-term borrowing as well as some credits of up to five years. Also included are hard-currency balances with less developed countries and changes in gold and foreign exchange reserves.

Credits backed by Western governments represented the largest single source of debt financing; in 1975 they accounted for roughly one-third of Romania's total debt. Bucharest's borrowing from Western commercial banks has remained relatively small with estimated net liabilities totaling about $630 million by yearend 1975. Romania also had outstanding some $420 million from Iran, $60 million from Kuwait, about $160 million on two International Monetary Fund (IMF) credits, $150 million in West German supplier credits, and $40 million in US Commodity Credit Corporation (CCC) credits. Moreover, some $100 million in West German credits extended in 1970 and 1973 to help cover Romanian repayment obligations were still outstanding at the end of 1975, and Romania owed about $500 million to unspecified sources.

Romania continued to cut imports in the first half of 1976 (as compared with first half 1975), but then permitted a surge in the second half so that total imports for the year were at about the 1975 level. At the same time, exports rebounded and the trade deficit dropped by 60 percent to an estimated $200 million. By yearend 1976 the hard-currency debt had risen to roughly $3.3 billion. The Romanians required about $1 billion in new financing to cover the current account deficit plus debt repayments in 1976. It is estimated that Bucharest had at most only $200 million in government-guaranteed credits to draw on. In addition, Romania had available more than $100 million in World Bank credits[5] and $100 million from an Iranian bank and drew down $175 million from IMF standby arrangements. The balance of the required financing apparently was obtained from private banking sources, although BIS data indicate that Romanian borrowing on the Euromarket declined somewhat.

[5] Romania has been granted about $460 million in International Bank for Reconstruction and Development (IBRD) credits since 1973. It is believed that little of this was drawn down before 1976.

East Germany—The Burgeoning Debt to the West

East Germany's debt also has risen sharply as its appetite for Western goods has sharpened and the growth of Soviet deliveries of industrial materials and grain has slowed. By 1973, its trade deficit with the West had already hit $800 million. Skyrocketing import prices in 1974 and stagnating exports in 1975 boosted the deficit to $1 billion by 1975 in spite of East German efforts to cut back import growth. Total imports increased only 3 percent in 1975, although imports of grain and of machinery and equipment rose sharply. Total exports fell slightly in 1975, mainly because of a sharp decline in exports of iron and steel and of fuels.

The heavy borrowing required to cover the deficits pushed East Germany's hard-currency debt up from $2.1 billion at yearend 1973 to $3.8 billion at yearend 1975. Liabilities on private borrowing from commercial banks accounted for nearly two-thirds of the total debt at yearend 1975, whereas only 10 percent was in government-guaranteed credits. About one-fourth of the East German debt consisted of net liabilities to West Germany, as shown below (in million US dollars at yearend):

	1973	1974	1975	1976
Total net indebtedness	2.1	2.8	3.8	4.9
Of which:				
To West Germany[6]	0.6	0.8	0.9	1.1

Net East German liabilities to West Germany are referred to as the "cumulative active balance," which represents the balance of transactions processed through the clearing account less East German payments in deutsche marks to a special account. These liabilities consist of the amount outstanding on the interest-free swing credit, on nonguaranteed commercial credits, and on insurance and financing by the West German Gesellschaft zur Finanzierung von

[6] Converted at the West German exchange rate prevailing at the end of each year.

Industrieanlagen mbH (GeFi) and Treuarbeit A.G., which provide insurance and financing specifically for exports to East Germany. The amount outstanding on the swing credit at yearend 1975 was about $300 million.

Available data suggest that the East Germans failed to reduce their trade deficit in 1976. Although exports rose by an estimated 10 percent, the need for increased Western grain helped push total imports up. The East Germans borrowed heavily in the Eurocurrency market, increasing their net liabilities by $940 million in 1976 compared with an increase of $775 million in 1975. At the same time, net liabilities to West Germany rose by about $200 million. The hard-currency debt is estimated to have risen to $4.9 billion by yearend 1976.

Bulgaria—Riding the Eurocurrency Market

Bulgaria managed to keep its hard-currency debt under control until 1974-75 when Western inflation, a spurt in imports of machinery and equipment, and stagnating exports caused Bulgaria's trade deficits to rise almost ninefold to $700 million. Exports, which had done quite well through 1973, failed to rise in 1974 and 1975, mainly a result of sharp drops in sales of meat and live animals and of metals. At the same time, total imports doubled and imports of machinery and equipment tripled.

The heavy borrowing required to cover the large deficits boosted Bulgaria's net hard-currency debt from $800 million at yearend 1973 to $1.8 billion at yearend 1975. The debt service ratio rose sharply from 35 percent in 1973 to 60 percent in 1975 as repayments and interest burgeoned while exports stagnated. Bulgaria has been more dependent on private financing from commercial banks than any other East European country except Hungary. Estimated net liabilities to commercial banks accounted for about four-fifths of Bulgaria's debt.

Bulgaria pushed hard to reduce its 1976 trade deficit; imports were cut by an estimated 12 percent in 1976, while exports rose roughly 13 percent. Bulgaria's trade deficit was reduced by nearly $200 million to $550 million.

Early in 1976, it looked as though Bulgaria might be running into some payments problems when it made an apparently unsuccessful informal request to West Germany for debt rescheduling. There were no indications, however, that Sofia was delinquent in any of its payments, and it apparently had no difficulty in raising about $800 million in 1976 to cover its trade deficit and meet repayment obligations. Some government-guaranteed credits and one-half of a $160 million Iranian loan extended in 1975 were available. Reported borrowing on the Euromarket rose $300 million in 1976, down substantially from the $475 million borrowed in 1975. In October, Bankers Trust International of London (a subsidiary of Bankers Trust of New York) managed a five-year, $100 million loan for Bulgaria. Bulgaria's debt at the end of 1976 probably totaled $2.3 billion.

Hungary—Paring the Deficit

Although conservative in its financial dealings with the West, Hungary had to borrow heavily in 1974-75 to cover large deficits stemming from deteriorating terms of trade, the EC ban on beef and cattle imports,[7] and the weakening of Western demand. (See table 6 for trends in prices in trade with the developed West.) Even though Hungary took strong measures to curb imports in the second half of 1975, the trade deficit still hit a record $750 million for the year. Imports of chemicals and foodstuffs dropped sharply in 1975, but imports of machinery and equipment increased substantially. The sharpest drop in exports in 1975 occurred in metallurgical products, chemicals, and clothing and textiles.

Earnings from invisibles did little to reduce the deficit (see table 7). Hungary's net hard-cur-

[7] Hungarian exports to the developed West in 1974 would have been 5 percent higher if exports of meat and live animals had remained at the 1973 level.

Hungary: Terms of Trade With The Developed West — **Table 6**

Percent Change

	1972	1973	1974	1975[1]
Export prices	5.3	14.8	18.0	−5.4
Import prices	2.8	13.7	33.0	0.9
Terms of trade	2.4	1.0	−11.3	−6.2

[1] Estimated on the basis of Hungarian data.
SOURCE: Kulkereskedelmi statisztikai evkonyv for 1972, 1974, and 1975. Hungarian Statistical Office, Budapest.

Hungary: Estimated Hard-Currency Balance of Payments — **Table 7**

Million US $

	1970	1973	1974	1975	1976
Merchandise exports, f.o.b.[1]	558	1,085	1,221	1,096	1,290
Merchandise imports, f.o.b.[1]	575	1,045	1,680	1,700	1,710
Services and transfers, net[2]	−55	190	150	170	150
Interest, net	−30	−60	−90	−150	−180
Current account balance	−102	170	−399	−584	−450
Financed by					
Medium- and long-term credits, net	30	0	280	350	350
Errors and omissions[3]	72	−170	119	234	100

[1] Trade with the developed West, including Finland with which Hungary settles on a clearing basis. An approximation of Hungarian imports on an f.o.b. basis was calculated by adjusting official Hungarian data on imports, which are on a c.i.f. basis.
[2] Includes balances on transport, tourism, and private and government transfers.
[3] Includes short-term borrowing as well as some credits of up to five years. Also included are hard-currency balances with the less developed countries and changes in foreign exchange reserves.

rency debt soared from $900 million in 1973 to $2.1 billion in 1975. Debt service climbed from 20 percent to 35 percent of merchandise exports.

More than four-fifths of Hungary's debt outstanding at yearend 1975 consisted of commercial bank loans. Most of the increase in the debt was in long-term borrowing—Eurocurrency bonds and loans—which rose from 19 percent of the debt in 1970 to 42 percent in 1975. The relatively low share of government-backed credits (less than 10 percent) reflects not only Hungary's high dependence on the West for industrial materials—for which only short-term supplier credit is generally available—but also the government's policy of importing Western plant and equipment on a selective basis (usually on the expectation of a rapid payoff in exports).

Hungary again took measures to cut its imports in the first half of 1976, but then permitted a rise as exports picked up strongly. For the year as a whole, imports rose 1 percent while exports shot up by 18 percent, enabling Hungary to reduce its trade deficit by 24 percent to $570 million. Imports of machinery and equipment continued to rise, whereas those of industrial materials were held near the 1975 level. Much of the rapid rise in exports came from chemicals and metallurgical products. The Hungarians claim that in their total non-Communist trade the volume of imports grew faster than their value as prices declined 4 percent. Export prices rose 4 percent, and the terms of trade improved by 8 percent.

In 1976, known net borrowing on the Euromarket came to $700 million, up considerably from the $417 million borrowed in 1975. The debt rose to about $2.8 billion by yearend 1976. Debt service may have increased to about 40 percent of merchandise exports as repayments on the heavy 1975 borrowing began to fall due.

Czechoslovakia—Continuing Conservatism

Czechoslovakia has traditionally followed a conservative borrowing policy. Although its debt has risen rapidly in recent years, it is the only East European country whose debt does not substantially exceed annual exports. A rapid rise in imports of Western machinery and equipment helped push indebtedness up from $300 million to $800 million in 1971-73.

In 1974, Czechoslovakia—which exports largely manufactured goods in exchange for Western raw materials and semimanufactures—suffered a deterioration in its terms of trade as import prices soared. In 1975 the Western recession took its toll on Czechoslovak exports as well; exports declined 2 percent despite a rise in exports of machinery and equipment. Imports were up slightly as cutbacks in agricultural products and textiles were offset by the continued surge in imports of equipment and steel. Prague ended the year with a $1.5 billion debt. However, the resulting debt service payments represented only 22 percent of merchandise exports.

At the end of 1975, government-guaranteed credits accounted for perhaps 30 percent of the debt and West German supplier credits for more than half. Very little of the Czechoslovak debt consists of obligations to commercial banks; estimated liabilities of $560 million at yearend 1975 were offset to a considerable extent by assets of $310 million.

Because of the need for an unusually large quantity of Western grain due to last year's drought, Czechoslovakia was unable to reduce its trade deficit in 1976. Imports rose 9 percent—slightly more than the 8-percent increase in exports—and the deficit rose somewhat.

Prague substantially stepped up its Euromarket borrowing. Its known net liabilities rose by $472 million in 1976. In November it received its second publicized syndicated loan, a five-year, $200 million loan from a consortium of four West German banks. The loan ostensibly was earmarked for general debt repayments to West Germany but could have been used to pay for the large imports of Western grain. Estimated debt rose to $2.1 billion by yearend 1976.

Near Term Outlook

The East Europeans may have some difficult years ahead. Growing debt burdens will require them to cut back on the growth of imports in order to reduce trade deficits and slow the growth of their debts. They plan to keep import growth well below that in 1971-75. Poland, for example, plans to hold imports from the West at the 1975 level through 1980. In most cases, however, the import targets are unrealistically low in terms of economic growth goals. These countries are heavily dependent on imports of Western equipment and materials to generate economic growth. Even with the cutback in import growth, East European financing requirements for at least the next year or two would remain near the 1976 level as mounting repayment obligations offset reduced trade deficits.

The situation is further complicated by the fact that the East Europeans will now be relying less on the USSR for oil and industrial materials. Moreover, they may have to divert some potential hard-currency exports to the USSR to cover deficits created by worsening terms of trade resulting from higher CEMA—especially Soviet—prices.

In 1977, Poland, Czechoslovakia, and East Germany will be helped in their quest to restrict the growth of imports by Soviet grain deliveries, which had been reduced in 1975 and 1976. They will then be able to cut imports of Western grain if they have normal harvests. On the other hand, export growth may be limited if economic recovery in the West continues to lag. In addition, the terms of trade of some of the countries will worsen as prices of imported oil and chemicals rise. Thus, the trade deficit could again exceed $5 billion. Poland, which may cut its imports in absolute terms, is still expected to incur a deficit in excess of $2.5 billion.

By the end of the year, net hard-currency indebtedness could rise to more than $30 billion. Although sizable government- and government-guaranteed credits[8] are available, the East Europeans may have to go into the Euromarket even more heavily than in 1976 to meet their growing repayment obligations. But because of growing banker concern some countries—notably Bulgaria and Poland—may have difficulty raising all they need even at relatively high interest rates.

Beyond 1977

A critical problem facing the East European leaders is how to keep up the imports of the

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industrial materials, agricultural products, and consumer manufactures deemed necessary to meet economic growth plans and consumer requirements. Under the most favorable conditions—a strong recovery in exports and good harvests—most East European countries should be able to import the necessary industrial materials without economic or financial assistance. But they can do this only if they are willing to curb their imports of machinery and equipment. All the East European countries have, in fact, indicated their intention of allowing little if any growth in (or even cutting) imports of Western capital equipment. Such imports can be curbed for a time without much effect on economic growth, especially in Poland where there is a large backlog of equipment not yet in operation.

If recovery in the West is sluggish, the East Europeans face the prospect of having to cut back their economic growth. Poor harvests would make this even more imperative. Under these circumstances, it is unlikely that the East Europeans could import the necessary industrial materials without outside help. The East Europeans' tendency to overstockpile will ensure an adequate supply of industrial materials for perhaps another year, but thereafter failure to raise imports would result in serious bottlenecks in production.

Moscow apparently is concerned enough about Eastern Europe's economic difficulties—especially those which threaten political stability—to provide some assistance, even at the cost of some of its own hard-currency exports. Gierek's recent success in obtaining a large Soviet aid package—including additional deliveries of oil—could set the stage for assistance to other East European countries. Such aid probably would consist mainly of above-plan deliveries of raw materials and permission to continue running sizable deficits in trade with the USSR. The Soviets also might extend some hard-currency credits, but these are not expected to be large. Whatever assistance they provide, however, probably will not be sufficient to free Eastern Europe from the need to closely control imports.

Consequently, the East Europeans may have to ask the West for some assistance. Poland in particular is in a bind. Even under favorable circumstances—a strong recovery in exports, good harvests, and zero import growth—Warsaw will continue to need an average of $4 billion a year in new financing in 1977-80. Only $2 billion a year at best is expected to come from Western government and government-backed credits. The remainder will have to come mainly from the Euromarket. If Western bankers remain reluctant to provide all that Poland wants, Warsaw will try to get additional financing any way it can, including joining the IMF. If all else fails, Warsaw may have to seek rescheduling or refinancing of a substantial part of its debt.

Bulgaria, with by far the heaviest debt burden in Eastern Europe, may well be bailed out by the Soviets, who have come to its aid on at least one previous occasion. Otherwise, it also may be forced to seek rescheduling or refinancing in the West.

Romania, having sharply reduced its trade deficit in 1976, probably is in the best position to expand its imports without resorting to heavy commercial bank borrowing. As the only East European member of the IMF, it has substantial 20-year World Bank credits available, has recently lined up three government-backed credits, and can draw on its estimated $375 million in gold reserves.[9] But Romania's relatively favorable situation will prevail only as long as Romania's exports perform well and substantial imports of oil are not required.[10]

Czechoslovakia, East Germany, and Hungary probably can manage without major Western relief provided their exports pick up strongly. But if Western recovery remains sluggish for another year or two, they too could be looking to the West for help.

[9] The dollar value of Romanian gold reserves was derived by using a price of $135 per troy ounce.

[10] The recent earthquake reportedly damaged the Ploesti oil fields and refineries, which produce and process one-third of Romania's oil. Although available information is fragmentary, there is no clear indication that the damage to the oil facilities will significantly affect Romania's ability to meet its external and domestic oil requirements.

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APPENDIX B

Hard-Currency Trade with the LDCs

Information on how the East European countries earn hard currency from the LDCs is sparse. The largest part is generated from trade and is reflected in the trade balances with multilateral trading partners. Even these probably overstate the amount of Eastern Europe's hard-currency trade with the LDCs.

Part of the trade with LDC multilateral partners is on a barter or credit basis. In general, the method of payments is determined by the nature of the commodities involved. For example, a sizable part of East European exports of machinery and equipment to the LDCs probably is not paid for in hard currency. Thus, a large portion of any surpluses on trade with the multilateral LDC partners is not available as an offset to deficits on trade with the developed West.

Most of the data in the table below were derived by subtracting from total East European trade with the LDCs that portion which is known to be covered by bilateral clearing agreements. The data for Bulgaria and East Germany, however, were calculated on the basis of reporting on those LDCs with which Bulgaria and East Germany are believed to have multilateral payments agreements. The Bulgarians and East Germans omit from their trade data many of the LDC trading partners—both those with which they have bilateral payments agreements and those with which they presumably settle on a multilateral basis. In the case of Bulgaria, the omitted countries accounted for 25 percent of exports to and 18 percent of imports from the LDCs in 1974, and in the case of East Germany for 9 and 14 percent, respectively.

Eastern Europe: Trade With LDC Nonbilateral Trading Partners [1]

Million US $

	1973			1974			1975		
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
Bulgaria [2]	63	26	37	182	137	45	NA	NA	NA
Czechoslovakia	248	190	58	334	254	80	496	314	182
East Germany [2]	74	71	3	72	253	−181	NA	NA	NA
Hungary	109	75	34	202	175	27	241	256	−15
Poland	215	99	116	421	196	225	657	353	304
Romania	329	209	120	416	271	145	675	407	268
Total	**1,038**	**670**	**368**	**1,627**	**1,286**	**341**	**NA**	**NA**	**NA**

[1] Because of rounding, components may not add to the totals shown.

[2] Because Bulgaria and East Germany do not report trade with many of the LDCs, the data on their trade with LDC nonbilateral trading partners is incomplete.

SOURCE: Official East European foreign trade statistics.

Appendix C

STATISTICAL TABLES

Table C-1

Eastern Europe: Positions vis-a-vis Western Banks [1]

Million US $

	End 1974		End June 1975		End 1975		End June 1976		End 1976	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Eastern Europe	**2,000**	**7,366**	**1,856**	**9,601**	**2,718**	**11,407**	**2,742**	**13,142**	**3,164**	**15,639**
Bulgaria	253	1,098	222	1,396	282	1,600	224	1,786	355	1,973
Czechoslovakia	315	275	220	283	250	288	271	500	356	866
East Germany.	422	1,665	496	2,195	556	2,575	569	2,936	616	3,575
Hungary.........	468	1,497	429	1,878	748	2,194	909	2,726	899	3,051
Poland...........	407	2,076	321	2,935	508	3,870	441	4,372	643	5,442
Romania	135	755	168	914	374	880	328	822	295	732

[1] The Western countries reporting by individual East European country are Belgium-Luxembourg, France, Italy, Sweden, the United Kingdom, and West Germany; the Netherlands beginning end-June 1975; and branches of US banks in The Bahamas, Cayman Islands, Panama, Hong Kong, and Singapore beginning end 1975.
SOURCE: Bank for International Settlements.

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Table C-3

Eastern Europe: Estimated Debt Service Ratios [1]

Percent

	1970	1973	1974	1975	1976
Bulgaria	35	35	45	60	75
Czechoslovakia	8	15	17	22	30
East Germany	20	25	24	27	35
Hungary	20	20	24	35	40
Poland	20	21	27	43	50
Romania	36	35	29	42	42

[1] Repayments of principal on medium- and long-term debt and of interest on all debt as a percentage of merchandise exports to the developed West.

Table C-4

Eastern Europe: Estimated Hard-Currency Repayments and Interest, 1975 [1]

Millions US $

	Repayment of Medium- and Long-Term Liabilities	Interest	Total Debt Service
Bulgaria	140	100	240
Czechoslovakia	260	90	350
East Germany	500	210	710
Hungary	250	130	380
Poland	900	400	1,300
Romania	500	200	700

[1] Interest represents aggregate interest payments on all hard-currency debt.

Table C-5

Eastern Europe: Estimated Long-Term Debt [1]

In Percent of Total Net Indebtedness

	1970	1973	1974	1975
Bulgaria	15	25	25	33
Czechoslovakia	15	15	13	13
East Germany	10	19	14	16
Hungary	19	37	37	42
Poland	62	42	36	32
Romania	20	25	30	40

[1] Consists of credits of five years and more.

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MEMORANDUM FOR:

The Honorable Harold H. Saunders
Director
Bureau of Intelligence and Research
Department of State

Attached is your personal copy of our memorandum, "Eastern Europe: The Growing Hard Currency Debt," ER 77-10332, SECRET/NOT RELEASABLE TO FOREIGN NATIONALS.

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MAURICE C. ERNST
Director of Economic Research
Central Intelligence Agency

(DATE)
18 JUL 1977

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